

Message Text

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O R 151758Z DEC 76
FM AMEMBASSY LONDON
TO SECSTATE WASHDC IMMEDIATE 8792
TREASURY DEPT WASHDC IMMEDIATE
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AMEMBASSY TOKYO
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E.O. 11652: N/A
TAGS: EFIN, UK
SUBJECT: UK LETTER OF INTENT TO INTERNATIONAL MONETARY
FUND

SUMMARY: THE FOLLOWING IS THE TEXT OF THE UK'S LETTER OF
INTENT TO THE INTERNATIONAL MONETARY FUND:

QUOTE: 1. THE GOVERNMENT OF THE UNITED KINGDOM HEREBY
REQUESTS OF THE INTERNATIONAL MONETARY FUND A STAND-BY
ARRANGEMENT UNDER WHICH FOR A PERIOD OF TWO YEARS THE
GOVERNMENT OF THE UNITED KINGDOM WILL HAVE THE RIGHT TO
PURCHASE FROM THE FUND CURRENCIES OF OTHER MEMBERS IN EX-
CHANGE FOR STERLING UP TO AN AMOUNT EQUIVALENT TO SDR
3,360 MILLION. BEFORE MAKING PURCHASES UNDER THE STAND-
BY ARRANGEMENT, THE GOVERNMENT WILL CONSULT WITH THE
MANAGING DIRECTOR ON THE PARTICULAR CURRENCIES TO BE PUR-
CHASED FROM THE FUND.

2. THE PURPOSE OF THIS REQUEST IS TO SUPPORT THE POLI-
CIES THAT HAVE BEEN ADOPTED BY THE GOVERNMENT OF THE
UNITED KINGDOM TO STRENGTHEN THE BALANCE OF PAYMENTS AND
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CREATE THE CONDITIONS IN WHICH IT WILL BE POSSIBLE TO

GET BOTH UNEMPLOYMENT AND DOMESTIC INFLATION DOWN FROM THEIR PRESENT UNACCEPTABLE LEVELS AND KEEP THEM DOWN. THE STAND-BY ARRANGEMENT WILL ALSO HELP TO REPAY EXTERNAL DEBT NOW FALLING DUE AND ASSIST IN MAINTAINING ORDERLY CONDITIONS IN THE EXCHANGE MARKET FOR STERLING. THE GOVERNMENT'S OBJECTIVES AND POLICIES, WHICH I SHALL SUMMARIZE BELOW, HAVE BEEN SET OUT IN DETAIL IN RECENT POLICY PRONOUNCEMENTS, INCLUDING PARTICULARLY THE PRIME MINISTERS SPEECH TO THE HOUSE OF COMMONS ON 11 OCTOBER 1976, MY SPEECHES TO THE HOUSE ON 11 OCTOBER AND 30 NOVEMBER AND MY STATEMENT IN THE HOUSE THIS AFTERNOON.

3. SINCE THE SUMMER OF 1975, THE GOVERNMENT, WITH THE SUPPORT OF BOTH SIDES OF INDUSTRY, HAS PURSUED A MEDIUM-TERM STRATEGY WHOSE OBJECTIVES ARE TO REDUCE THE RATE OF INFLATION AND TO ACHIEVE A SUSTAINABLE GROWTH IN OUTPUT, EMPLOYMENT AND LIVING STANDARDS BASED ON A STRONG EXPANSION IN NET EXPORTS AND PRODUCTIVE INVESTMENT. IN ORDER TO SECURE THIS STRATEGY, THE WHITE PAPER ON PUBLIC EXPENDITURE PUBLISHED IN FEBRUARY 1976 (CMND. 6393) INDICATED THE GOVERNMENT'S INTENTION IN THE YEARS AHEAD TO REDUCE THE SHARE OF RESOURCES TAKEN BY PUBLIC EXPENDITURE. IT IS ALSO PART OF THIS STRATEGY TO REDUCE THE PUBLIC SECTOR BORROWING REQUIREMENT SO AS TO ESTABLISH MONETARY CONDITIONS WHICH WILL HELP THE GROWTH OF OUTPUT AND THE CONTROL OF INFLATION. THE GOVERNMENT SEES THIS STRATEGY AS THE BASIS FOR A THREE-YEAR PROGRAMME WHICH WILL FIRMLY ESTABLISH THE RECOVERY OF THE NATION'S ECONOMY AND WILL ALSO ALLOW THE UNITED KINGDOM TO MAKE ITS PROPER CONTRIBUTION TO THE STABILITY AND PROSPERITY OF THE WORLD.

4. THE TWO PILLARS ON WHICH THIS STRATEGY IS BASED ARE THE SOCIAL CONTRACT WITH THE TRADES UNION MOVEMENT, WHICH HAS ALREADY ALLOWED US TO ACHIEVE A SUBSTANTIAL REDUCTION IN THE RATE OF PRICE AND WAGE INFLATION AND HAS BROUGHT ABOUT A DRAMATIC IMPROVEMENT IN INDUSTRIAL RELATIONS; AND THE INDUSTRIAL STRATEGY, THROUGH WHICH THE GOVERNMENT, THE TRADE UNIONS AND THE EMPLOYERS ARE SEEKING TO IMPROVE THE PERFORMANCE OF OUR MANUFACTURING INDUSTRY AND, IN PARTICULAR, ITS PRODUCTIVITY AND ITS ABILITY TO

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COMPETE SUCCESSFULLY IN WORLD MARKETS. IT IS OUR FIRM INTENTION TO CONTINUE THE POLICY OF SECURING A PROGRESSIVE DECELERATION OF INFLATION THROUGH VOLUNTARY AGREEMENT BETWEEN THE GOVERNMENT AND THE TRADES UNION CONGRESS. UNDER THE FIRST STAGE OF THIS POLICY, THE INCREASE IN AVERAGE EARNINGS WAS REDUCED TO 13.9 PERCENT IN THE YEAR ENDING JULY 1976, FROM 27.6 PERCENT IN THE CORRESPONDING PERIOD A YEAR EARLIER. UNDER THE SECOND STAGE, THE TUC AND THE

GOVERNMENT ARE APPLYING THE PRESENT PAY AGREEMENT STRICTLY
AVERAGE EARNINGS RESULTING FROM THIS SECOND STAGE POLICY
IN THE PERIOD JULY 1976 TO JULY 1977 WILL RISE BY SOME-
THING LIKE HALF OF THE AMOUNT OF INCREASE IN THE PRECEDING
12 MONTHS. LARGELY BECAUSE OF THIS RESTRAINT IN EARNINGS

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THE RATE OF PRICE INCREASE HAS FALLEN SHARPLY FROM A RATE
OF 25.9 PERCENT IN THE 12 MONTHS TO OCTOBER 1975 TO ONE
OF 14.7 PERCENT IN THE 12 MONTHS TO OCTOBER 1976. IN RE-
CENT MONTHS THIS PROGRESS HAS BEEN INTERRUPTED BECAUSE OF
THE SHARP RISE IN COMMODITY PRICES, THE EFFECTS OF THE
DROUGHT AND THE DEPRECIATION OF THE EXCHANGE RATE OF STER-
LING. NEVERTHELESS THE GOVERNMENT IS DETERMINED TO
ENSURE THAT THE RATE OF INFLATION CONTINUES TO FALL.
ACCORDINGLY, IT WILL BEGIN EARLY NEXT YEAR TO CONSIDER,
IN CONSULTATION WITH THE TUC AND THE CBI, HOW THIS OBJEC-
TIVE CAN BEST BE PURSUED IN THE PERIOD BEYOND JULY 1977.
I WOULD AIM AT REACHING AGREEMENT THROUGH THESE CONSUL-

TATIONS IN THE EARLY SPRING OF NEXT YEAR, IN TIME FOR THE BUDGET. THIS WILL ENSURE THAT THE GAINS ACHIEVED BY THE SACRIFICES ALREADY MADE ARE FURTHER IMPROVED AND THAT THERE IS CONTINUED PROGRESS IN BRINGING THE RATE OF INFLATION IN THE UNITED KINGDOM DOWN TO THAT OBTAINING IN THE OTHER MAIN INDUSTRIAL COUNTRIES.

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5. WORK TO DEVELOP AN INDUSTRIAL STRATEGY CAN PRODUCE MAJOR RESULTS ONLY IN THE MEDIUM-TERM, BUT SIGNIFICANT PROGRESS HAS BEEN MADE IN THE LAST 12 MONTHS. THE CURRENT PHASE OF THE WORK IS DIRECTED TO INCREASING MARKET SHARES AT HOME AND ABROAD, THROUGH IMPROVEMENTS IN INDUSTRIAL PRODUCTIVITY AND NON-PRICE COMPETITIVENESS. IT IS THE GOVERNMENT'S POLICY TO CREATE THE CONDITIONS IN WHICH A STRONG BRITISH MANUFACTURING INDUSTRY CAN CONTRIBUTE TO THE IMPROVEMENT OF OUR BALANCE OF TRADE AND PAYMENTS.

6. I HAVE REPEATEDLY STRESSED THAT THE GOVERNMENT AIMS TO STRENGTHEN THE BALANCE OF PAYMENTS PROGRESSIVELY OVER THE COMING YEARS AS ONE ESSENTIAL CONDITION FOR SUSTAINED GROWTH AND A HIGH LEVEL OF EMPLOYMENT. ON THE BASIS OF OUR PRESENT PROJECTIONS FOR THE GROWTH OF WORLD TRADE AND PRICES, THE GOVERNMENT EXPECTS THAT THE DEFICIT ON CURRENT ACCOUNT WILL FALL FROM OVER 2 BILLION POUNDS IN 1976/77 TO ABOUT 1 BILLION POUNDS IN 1977/78, AND THEN MOVE INTO A SURPLUS OF SOME 2 TO 3 BILLION POUNDS IN 1978/79. IN THE COMING YEARS THE CURRENT ACCOUNT WILL INCREASINGLY BENEFIT FROM PRODUCTION OF NORTH SEA OIL AND GAS. THIS PROSPECT TOGETHER WITH CONTINUED PROGRESS IN IMPROVING THE NON-OIL COMPONENT OF OUR EXTERNAL ACCOUNTS WILL ALLOW US TO REDUCE THE LARGE OUTSTANDING AMOUNT OF FOREIGN DEBT THAT HAS BEEN ACCUMULATED AND AT THE SAME TIME TO RECONSTITUTE OUR FOREIGN EXCHANGE RESERVES. HOWEVER, I MUST EMPHASIZE THAT AN IMPROVEMENT OF THIS MAGNITUDE MUST DEPEND ON A SATISFACTORY RATE OF EXPANSION IN WORLD TRADE. IT IS NOT POSSIBLE FOR DEFICIT COUNTRIES TO IMPROVE THEIR POSITION UNLESS COUNTRIES WITH A STRONG BALANCE OF PAYMENTS ENSURE A SATISFACTORY RATE OF GROWTH IN THEIR ECONOMIES AND ARE PREPARED TO ACCEPT A DETERIORATION IN THEIR OWN EXTERNAL POSITION.

7. THE GOVERNMENT IS DETERMINED TO CARRY THROUGH A STABILISATION PROGRAMME WHICH WILL BRING THE ECONOMY INTO BALANCE AND WHICH, IF IT IS NOT TO PRODUCE UNACCEPTABLE SOCIAL TENSIONS AND LEVELS OF UNEMPLOYMENT, WILL NEED TO EXTEND OVER TWO TO THREE YEARS. THE CHANGES REQUIRED BY THIS PROGRAMME MUST PROCEED AT A PACE WHICH WILL NOT OVERSTRAIN THE CONSENSUS ON WHICH OUR POLICIES FOR REGENER-

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ATING INDUSTRY AND REDUCING INFLATION MUST DEPEND. THE GOVERNMENT IS DEEPLY CONSCIOUS THAT THE PRESENT STATE OF THE ECONOMY HAS BROUGHT A WASTE OF HUMAN AND MATERIAL RESOURCES. THE GOVERNMENT'S OBJECTIVE IS TO BREAK DECISIVELY AWAY FROM THE CONSTRICTING PATTERN OF PRESENT CIRCUMSTANCES AND POST-WAR DISAPPOINTMENTS. IT WILL THEREFORE KEEP A CLOSE WATCH ON THE DEVELOPMENT OF THE ECONOMY, SO THAT IF ANY FURTHER ACTION IS NEEDED, IT CAN BE TAKEN IN GOOD TIME TO ENSURE THAT CONDITIONS ARE FAVOURABLE FOR THE NECESSARY SHIFT OF RESOURCES INTO EXPORTS AND PRODUCTIVE INVESTMENT. FOR THIS PURPOSE, AN ESSENTIAL ELEMENT OF THE GOVERNMENT'S STRATEGY WILL BE A CONTINUING AND SUBSTANTIAL REDUCTION OVER THE NEXT FEW YEARS IN THE SHARE OF RESOURCES REQUIRED FOR THE PUBLIC SECTOR. IT IS ALSO ESSENTIAL TO REDUCE THE PUBLIC SECTOR BORROWING REQUIREMENT (PSBR) IN ORDER TO CREATE MONETARY CONDITIONS WHICH WILL ENCOURAGE INVESTMENT AND SUPPORT SUSTAINED GROWTH AND THE CONTROL OF INFLATION. IN THE FOLLOWING PARAGRAPHS OF THIS LETTER I WILL DESCRIBE THE POLICIES WHICH THE GOVERNMENT WILL THEREFORE FOLLOW OVER THE NEXT TWO YEARS: THE POLICIES FOR THE SECOND YEAR -- THE FINANCIAL YEAR 1978/79 -- WILL BE REVIEWED BEFORE THE END OF 1977, IN THE LIGHT OF ECONOMIC DEVELOPMENTS AND PROSPECTS.

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8. OUR MOST RECENT FORECAST SHOWS THE PSBR IN 1976/77 TO BE 11.2 BILLION POUNDS. THIS IS LESS THAN THE FIGURE OF 12 BILLION POUNDS FORECAST. THEN I REQUESTED A STAND-BY ARRANGEMENT IN THE FIRST CREDIT TRANCHE IN DECEMBER 1975. THIS IMPROVEMENT IN THE EXPECTED OUTCOME REFLECTS HIGHER REVENUES BECAUSE OF THE HIGHER RATE OF INFLATION REFERRED TO IN PARAGRAPH 4 ABOVE AND THE IMPROVED FINANCIAL POSITION OF THE PUBLIC CORPORATIONS; AND IT HAS ALSO BEEN ASSISTED BY THE PROGRESS THAT HAS RECENTLY BEEN MADE IN ESTABLISHING FIRM CONTROL OVER LARGE AREAS OF PUBLIC EXPENDITURES BY THE USE OF CASH LIMITS AND OUR REFUSAL TO SANCTION EXPENDITURE BEYOND THE TOTAL SET IN LAST FEBRUARY'S WHITE PAPER FOR PROGRAMMES AND THE CONTINGENCY RESERVE.

9. IN THE WHITE PAPER OF FEBRUARY THIS YEAR (CMND 6393) THE GOVERNMENT INTRODUCED POLICIES TO MOVE RESOURCES INTO THE BALANCE OF PAYMENTS AND INVESTMENT BY REDUCING PUBLIC UNCLASSIFIED

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EXPENDITURE IN BOTH 1977/78 AND 1978/79. IN JULY 1976, IT MADE FURTHER REDUCTIONS IN PUBLIC EXPENDITURE PROGRAMMES FOR THE YEAR 1977/78, OF THE ORDER OF 1 BILLION POUNDS AT 1976 SURVEY PRICES. IT ALSO ANNOUNCED A SURCHARGE ON EMPLOYERS' NATIONAL INSURANCE CONTRIBUTIONS, TO BECOME EFFECTIVE ON 6 APRIL 1977, WHICH WILL YIELD SOME 1 BILLION POUNDS IN ADDITIONAL REVENUE IN 1977/78.

10. SINCE THESE MEASURES WERE ANNOUNCED, THERE HAVE BEEN PERIODS OF INSTABILITY IN THE EXCHANGE MARKET AND PRESSURE ON MONETARY AGGREGATES, WHICH HAVE LED TO A STEEP INCREASE IN INTEREST RATES; THESE, IF SUSTAINED, WOULD DAMAGE OUR ECONOMIC PERFORMANCE IN SEVERAL AREAS. I AM THEREFORE CONVINCED THAT A FURTHER REDUCTION IN PUBLIC EXPENDITURE AND IN THE PUBLIC SECTOR BORROWING REQUIREMENT IS UNAVOIDABLE.

11. TO REMOVE THIS INSTABILITY, THEREFORE, THE GOVERNMENT HAS DECIDED TO REDUCE PUBLIC EXPENDITURE PROGRAMMES IN 1977/78 BY A FURTHER 1 BILLION POUNDS AND IN 1978/79 BY 1-1/2 BILLION POUNDS, AT 1976 SURVEY PRICES IN BOTH CASES. DETAILS ARE SET OUT IN MY STATEMENT TO THE HOUSE OF COMMONS TODAY. AT THE SAME TIME I WISH TO GIVE THE MAXIMUM POSSIBLE HELP TO INDUSTRY AND TO AVOID UNNECESSARY UNEMPLOYMENT. I THEREFORE INTEND TO INCREASE EXPENDITURE ON INCENTIVES FOR INDUSTRIAL INVESTMENT AND EXPANSION AND ON MEASURES TO REDUCE UNEMPLOYMENT IN EACH OF THE TWO YEARS 1977/78 AND 1978/79 BY 200 MILLION POUNDS. THIS EXPENDITURE WILL BE FINANCED BY AN INCREASE OF 10 PERCENT IN THE DUTIES ON ALCOHOL AND TOBACCO.

12. AS A RESULT OF THESE MEASURES AND OF A SALE DURING 1977/78 OF BRITISH PETROLEUM SHARES CALCULATED TO YIELD 500 MILLION POUNDS, THE AIM IS TO HOLD THE PSBR TO 8.7 BILLION POUNDS IN THAT YEAR. AS A PROPORTION OF GDP AT MARKET PRICES THE PSBR WILL, THEREFORE, FALL FROM ABOUT 9 PERCENT IN 1976/77 TO ABOUT 6 PERCENT IN 1977/78. IF, AT THE TIME I PLAN MY BUDGET FOR 1977/78, I JUDGE THAT WITHOUT INCREASING THE PSBR ABOVE 8.7 BILLION POUNDS THERE IS SCOPE FOR TAX RELIEFS AND IF, AS I HOPE, A SATISFACTORY AGREEMENT HAS BEEN REACHED WITH THE TUC AND THE CBI ON PAY

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ARRANGEMENTS FOR THE PERIOD AFTER JULY 1977, THEN I WOULD PLAN TO USE THE AVAILABLE MARGIN TO REDUCE THE PRESENT BURDEN OF DIRECT TAXATION. MY OWN BELIEF IS THAT PRESENT LEVELS OF DIRECT TAXATION HAVE PROVED DISCOURAGING TO EFFORT AND EFFICIENCY, AND IF THEY WERE TO CONTINUE UNCHANGED THEY COULD THREATEN THE IMPROVEMENT IN OUR ECONOMIC PERFORMANCE WHICH IS AN ESSENTIAL OBJECTIVE OF THE GOVERNMENT'S STRATEGY.

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THE PROFILE OF PUBLIC EXPENDITURE AFTER THESE REDUCTIONS AND THOSE MENTIONED EARLIER IN THIS LETTER CAN THEREFORE BE STATED AS FOLLOWS. THE TOTAL OF PUBLIC EXPENDITURE PROGRAMMES FOR THE FINANCIAL YEAR 1976/77 (EXCLUDING DEBT INTEREST AND CAPITAL FINANCE FOR NATIONALIZED INDUSTRIES) IS NOW EXPECTED TO BE ABOUT 1 PERCENT MORE IN VOLUME THAN IN 1975/76, WHEN IT WAS APPROXIMATELY 50-1/2 POUNDS BILLION AT 1976 SURVEY PRICES. THIS LATEST 1976/77 ESTIMATE IS WITHIN THE CORRESPONDING PROVISION FOR THESE PROGRAMMES AND THE CONTINGENCY RESERVE IN THE LAST PUBLIC EXPENDITURE WHITE PAPER (CMND. 6393). THE LEVEL IN 1977/78, AFTER THE MEASURES ANNOUNCED IN JULY AND THE FURTHER REDUCTIONS NOW DECIDED, IS PLANNED TO FALL TO ABOUT 1 PERCENT BELOW THAT OF 1975/76 AT 1976 SURVEY PRICES WITHOUT TAKING ACCOUNT OF THE PROCEEDS OF THE PLANNED SALE OF BRITISH PETROLEUM SHARES. THE PLANNED LEVEL FOR 1978/79 WILL ALSO BE ABOUT 1 PERCENT BELOW THAT FOR 1975/76. THAT PART OF TOTAL EXPENDITURE WHICH UNCLASSIFIED

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IS DUE TO PROVISION FOR SOCIAL SECURITY BENEFITS FOR THE UNEMPLOYED IS HOWEVER SUBJECT TO A MARGIN OF FLUCTUATION ACCORDING TO THE ACTUAL LEVEL OF UNEMPLOYMENT. THE REVISED EXPENDITURE PROGRAMMES INCORPORATING THE CHANGES WHICH I HAVE DESCRIBED WILL BE PUBLISHED IN THE NEXT PUBLIC EXPENDITURE WHITE PAPER. THE IMPLICATION OF THE FIGURES WHICH I HAVE GIVEN IS THAT THE PUBLISHED TOTAL FOR

PROGRAMMES PLUS THE CONTINGENCY RESERVE, BUT EXCLUDING ON THE ONE HAND RECEIPTS FROM THE SALE OF THE BRITISH PETROLEUM SHARES AND ON THE OTHER HAND DEBT INTEREST AND CAPITAL FINANCE FOR THE NATIONALISED INDUSTRIES, WILL BE AROUND 50 BILLION POUNDS OR SOMEWHAT LESS IN 1977/78 AND AROUND 50 BILLION POUNDS AGAIN IN 1978/79. AT 1976 SURVEY PRICES IN BOTH CASES. CAPITAL FINANCE FOR THE NATIONALISED INDUSTRIES MOBILISED BY THE GOVERNMENT IS ESTIMATED TO BE BROADLY STABLE OVER THIS PERIOD.

14. I ALSO INTEND TO TAKE FURTHER FISCAL ACTION TOTALLING 0.5 BILLION POUNDS AT 1976 PRICES AFFECTING 1978/79 IN ORDER TO BRING THE PSBR FOR THAT YEAR DOWN TO 8.6 BILLION POUNDS IN NOMINAL TERMS; THIS WOULD REPRESENT A FALL IN THE LEVEL OF THE PSBR TO SOME 5-1/4 PERCENT OF GDP AT MARKET PRICES IN THAT YEAR

15. THE GOVERNMENT HAS DETERMINED THESE OBJECTIVES QFEW PSBR ON THE BASIS OF A FORECAST THAT THE GROSS DOMESTIC PRODUCT WILL SHOW AN INCREASE OF ABOUT 2 PERCENT IN 1977/78 COMPARED WITH 1976/77. FOLLOWED BY A SOMEWHAT LARGER INCREASE OF 2-1/2 - 3 PERCENT BETWEEN 1977/78 AND 1978/79.

16. IN CARRYING OUT THE ANNUAL SURVEY OF PUBLIC EXPENDITURE PROGRAMMES IN 1977 AND IN PREPARING MY 1978 BUDGET, I SHALL CONTINUE TO BE GUIDED BY THE NEED, WHICH IS AN ESSENTIAL ELEMENT IN OUR STRATEGY, TO SHIFT RESOURCES INTO THE EXPORT AND INVESTMENT SECTORS AND I SHALL, THEREFORE, TAKE FULL ACCOUNT OF THE PROSPECTIVE GROWTH OF OUTPUT AND ENSURE THAT NOTHING STANDS IN THE WAY OF THIS SHIFT OF RESOURCES. IN PARTICULAR, IF THE FORECAST RATE OF GROWTH FROM THE BEGINNING OF 1978 TO THE END OF 1979 IS IN EXCESS OF 3.5 PERCENT PER ANNUM, I SHALL -- IN OR-
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DER TO ALLOW FOR IT -- MAKE AN ADDITIONAL FISCAL ADJUSTMENT IN 1978/79 OF BETWEEN 500 MILLION POUNDS AND 1,000 MILLION POUNDS AT 1976 PRICES. THE EXACT FIGURE WOULD

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DEPEND ON THE BUOYANCY OF AGGREGATE DEMAND.

17. A REDUCTION IN THE PSBR WILL GO A LONG WAY TO IMPROVE OUR ABILITY TO CONTROL THE RATE OF GROWTH OF THE MONETARY AGGREGATES, AND WILL HELP TO REDUCE THE LEVEL OF INTEREST RATES WHICH MIGHT OTHERWISE BE AN IMPEDIMENT TO INCREASED INDUSTRIAL INVESTMENT. I HAVE REPEATEDLY STRESSED THAT OUR POLICIES SHOULD NOT BE UNDERMINED BY AN EXCESSIVE EXPANSION OF CREDIT. IN THE FIRST HALF OF 1976/77, THE GROWTH OF BANK LENDING ROSE MUCH MORE RAPIDLY THAN EXPECTED, AND THIS CONTRIBUTE TO PRESSURES ON THE POUND. TO COUNTER THESE DEVELOPMENTS, A SERIES OF MEASURES HAS BEEN TAKEN. IN SEPTEMBER AND OCTOBER 1976, THE BANK OF ENGLAND INCREASED THEIR MINIMUM LENDING RATE SUBSTANTIALY AND CALLED FOR SPECIAL DEPOSITS FROM THE BANKING SYSTEM AMOUNTING IN ALL TO 3 PERCENT OF ELIGIBLE LIABILITIES. IN NOVEMBER 1976, THE BANK OF ENGLAND REINTRODUCED THE SYSTEM OF SUPPLEMENTARY SPECIAL DEPOSITS WHICH SHOULD ENSURE THAT THE GROWTH OF CREDIT AND THE MONEY

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AGGREGATES IS BROUGHT UNDER CONTROL QUICKLY. THE GOVERNMENT IS DETERMINED THAT BANK CREDIT EXPANSION WILL NOT UNDERMINE THE STABILITY OF THE EXCHANGE MARKET.

18. I ACCORDINGLY INTEND THAT DOMESTIC CREDIT EXPANSION SHOULD BE KEPT TO 9 BILLION POUNDS IN THE 12 MONTHS ENDING 20 APRIL 1977 AND TO 7.7 BILLION POUNDS IN THE 12 MONTHS ENDING 19 APRIL 1978. I INTEND HOWEVER TO REVIEW THE LATTER FIGURE EARLY IN THE FINANCIAL YEAR AND TO TAKE ACCOUNT OF THE PROSPECTIVE FINANCIAL REQUIREMENTS OF INDUSTRY FOR INVESTMENT AND EXPANSION. IT IS THE GOVERNMENT'S INTENTION THAT THE COURSE DURING EACH YEAR OF DOMESTIC CREDIT EXPANSION (DCE), AND OF THE PUBLIC SECTOR BORROWING REQUIREMENT WITHIN IT, SHOULD BE CONSISTENT WITH THE INTENDED RESULTS FOR THE YEAR AS A WHOLE AND TO TAKE ACTION AS APPROPRIATE TO THIS END.

19. IN THE YEAR ENDING 18 APRIL, 1979 I EXPECT THE EXPANSION OF DOMESTIC CREDIT TO BE FURTHER REDUCED TO 6 BILLION POUNDS. THIS, HOWEVER, WILL HAVE TO BE REVIEWED LATE IN 1977 IN THE LIGHT OF THE PROSPECTS FOR 1978/79. IN THAT REVIEW AN APPROPRIATE DOWNWARD ADJUSTMENT WILL BE MADE IN THE INTENDED RATE OF DOMESTIC CREDIT EXPANSION FOR ANY REDUCTION IN THE PUBLIC SECTOR BORROWING REQUIREMENT FOR 1978/79 THAT MAY RESULT FROM THE REVIEW DESCRIBED IN PARAGRAPH 16.

20. I INTEND TO FUND THE MAJOR PART OF THE PSBR OUTSIDE THE BANKING SYSTEM, SO THAT THERE CAN BE ROOM WITHIN THESE LEVELS OF DOMESTIC CREDIT EXPANSION FOR BANK CREDIT TO FACILITATE THE SHIFT OF RESOURCES INTO EXPORTS AND PRODUCTIVE INVESTMENT. I ENVISAGE THAT THE MEASURES WHICH I HAVE NOW TAKEN, ESPECIALLY THOSE TO REDUCE THE PSBR, WILL MAKE IT POSSIBLE TO REDUCE INTEREST RATES PROGRESSIVELY FROM THEIR PRESENT EXCEPTIONAL LEVELS, WHILE MAINTAINING EFFECTIVE CONTROL OF THE MONETARY AGGREGATE.

21. FOR AT LEAST THE IMMEDIATE FUTURE, THE SUPPLEMENTARY SPECIAL DEPOSITS SCHEME, INVOLVING GUIDELINES FOR THE GROWTH OF BANKS' INTEREST-BEARING LIABILITIES, WILL BE A KEY INSTRUMENT FOR CONTROLLING THE GROWTH OF BANK CREDIT

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TO THE PRIVATE SECTOR. IT MAY ALSO CAUSE SOME SHIFT OF HOLDINGS OF SHORT-TERM PUBLIC SECTOR DEBT AWAY FROM THE BANKING SYSTEM. DISTORTING THE DCE AND MONEY SUPPLY STATISTICS, WITHOUT AFFECTING THE UNDERLYING STATE OF LIQUIDITY IN THE ECONOMY: IF THIS HAPPENS I INTEND TO KEEO DCE CORRESPONDINGLY LOWER THAN THE TARGETS SET OUT ABOVE.

22. WHILE THE EXACT IMPLICATIONS OF THE TARGETS FOR DCE FOR THE GROWTH OF THE MONEY SUPPLY, AND IN PARTICULAR FOR STERLING M3, WILL DEPEND ON THE SPEED OF PROGRESS IN ACHIE

VING OUR BALANCE OF PAYMENTS OBJECTIVES, I AM SATISFIED
THAT THE RESULTANT COURSE OF STERLING M3 WILL BE CONSIS-
TENT WITH A REDUCTION IN INFLATION.

23. DURING THE PAST YEAR THE PROBLEMS OF FINANCING OUR
EXTERNAL AND INTERNAL DEFICITS HAVE SERIOUSLY HAMPERED
PROGRESS IN ACHIEVING OUR GOALS. THE EXCHANGE MARKET,
IN PARTICULAR, HAS BEEN A CONSPICUOUS CAUSE OF UNCERTAIN-
TY, THEREBY UNDOUBTEDLY DELAYING THE RECOVERY OF THE
ECONOMY. THE MEASURES NOW TAKEN BY THE GOVERNMENT GIVE
ASSURANCE THAT PRIVATE BUSINESS DECISIONS CAN BE TAKEN
AGAINST THE BACKGROUND OF A CLEARLY DEFINED POLICY. IN-
TERVENTION WILL BE DESIGNED TO MINIMISE DISRUPTIVE SHORT-
TERM FLUCTUATIONS IN THE RATE AND TO MAINTAIN STABILITY

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ACTION EUR-12

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INFO AMEMBASSY BONN
AMEMBASSY PARIS
AMEMBASSY ROME
AMEMBASSY TOKYO
USMISSION OECD PARIS
USMISSION EC BRUSSELS

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IN THE EXCHANGE MARKETS CONSISTENTLY WITH THE CONTINUED
MAINTENANCE OF THE COMPETITIVE POSITION OF UK MANUFAC-
TURES BOTH AT HOME AND OVERSEAS. IT IS MY BELIEF THAT

THIS, IN CONJUNCTION WITH THE CONTINUED RESTRAINT OF DOMESTIC DEMAND, A STEADY IMPROVEMENT IN NON-PRICE COMPETITIVENESS AND PROGRESS IN ALIGNING OUR COST AND PRICE INFLATION TO THOSE OF OUR MAJOR PARTNERS, WILL ALTER THE LONG-STANDING TREND FOR THE UK SHARE OF WORLD MARKETS TO DIMINISH, AND LIMIT MORE EFFECTIVELY THE CONTINUING PENETRATION OF THE DOMESTIC MARKET BY IMPORTED MANUFACTURES, THEREBY PROMOTING INDUSTRIAL GROWTH IN THE UK. IT SHOULD ALSO HELP TO SECURE US A MUCH-NEEDED IMPROVEMENT IN OUR RESERVES POSITION. THE UNITED KINGDOM AUTHORITIES STRESS THEIR SUPPORT OF THE EXECUTIVE BOARD DECISION OF 23 JANUARY 1974, ON CONSULTATIONS ON MEMBERS' POLICIES IN PRESENT CIRCUMSTANCES. AND REITERATE THEIR INTENTION TO COLLABORATE WITH THE FUND IN ACCORDANCE WITH THE PROVISIONS OF ARTICLE IV' SECTION 4(A).

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24. THE GOVERNMENT REMAINS FIRMLY OPPOSED TO GENERALIZED RESTRICTIONS ON TRADE AND DOES NOT INTEND TO INTRODUCE RESTRICTIONS FOR BALANCE OF PAYMENTS PURPOSES. IT CONTINUES TO BELIEVE, HOWEVER, THAT IN CURRENT ECONOMIC CIRCUMSTANCES THERE MAY BE CASES WHERE PARTICULAR INDUSTRIES WHICH ARE VIABLE IN THE LONG-TERM ARE SUFFERING SERIOUS INJURY AS A RESULT OF INCREASED IMPORTS. THE GOVERNMENT HAS INTRODUCED CERTAIN TEMPORARY SELECTIVE MEASURES IN A NUMBER OF SUCH CASES AND HAS STATED THAT IT IS PREPARED TO CONSIDER THE FURTHER USE OF SUCH MEASURES WHERE THEY MAY BE JUSTIFIED IN SIMILAR CASES WHICH MAY ARISE. IT WILL BE THE GOVERNMENT'S POLICY TO REDUCE SUCH PROTECTIVE MEASURES AS SOON AS CIRCUMSTANCES PERMIT. DURING THE PERIOD OF THE STAND-BY ARRANGEMENT, THE GOVERNMENT DOES NOT INTEND TO INTRODUCE ANY MULTIPLE CURRENCY PRACTICES OR IMPOSE NEW OR INTENSIFY EXISTING RESTRICTIONS ON PAYMENTS AND TRANSFERS FOR CURRENT INTERNATIONAL TRANSACTIONS.

25. THE GOVERNMENT BELIEVES THAT THE POLICIES SET OUT IN THIS LETTER ARE ADEQUATE TO ACHIEVE THE OBJECTIVES OF ITS PROGRAMME, BUT WILL TAKE ANY FURTHER MEASURES THAT MAY BECOME APPROPRIATE FOR THIS PURPOSE. THE UNITED KINGDOM GOVERNMENT WILL CONSULT THE FUND IN ACCORDANCE WITH THE POLICIES OF THE FUND ON SUCH CONSULTATION ON THE ADOPTION OF ANY MEASURES THAT MAY BE APPROPRIATE. IN ANY CASE, THE UNITED KINGDOM AUTHORITIES WILL REACH UNDERSTANDINGS WITH THE FUND BEFORE 16 JANUARY, 1978 ON THEIR POLICY INTENTIONS FOR THE REMAINING PERIOD OF THE STAND-BY ARRANGEMENT. (DENIS HEALEY) END QUOTE.
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